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THE URUGUAY ROUND AT HALF-TIME: STRENGTHENING THE TRADING SYSTEM

The Uruguay Round Agenda and Prospects for Montreal
by John M. Curtis

Agriculture and the Montreal GATT Ministerial Meeting: Ending the Trade Wars
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International Economic Issues *is an occasional publication of the Institute for Research on Public Policy. The purpose is to present and stimulate timely analysis of economic issues as they emerge on the international agenda. The articles are prepared under the editorial supervision of Murray G. Smith, Director of the International Economics Program. As working papers for discussion purposes, these publications are not subject to the formal review processes which apply to monographs published by the Institute. Conclusions or recommendations in a publication of the Institute are solely those of the author and not of the Institute, its Board, Council or contributors.*

INTRODUCTION

by

Murray G. Smith*

On the eve of the Ministerial Meeting to review progress in the Uruguay Round, it is useful to recall how greatly the world has changed in the 40 years since the formation of the General Agreement on Tariffs and Trade (GATT). Then trade among the industrial countries was impeded by high tariffs and exchange rate controls not unlike the situation prevailing among many developing countries today. Yet having endured the economic chaos of the Great Depression, economic policymakers in the key countries, most notably the United States and the United Kingdom, recognized that an orderly framework for trade and steady progress toward trade liberalization was essential to assuring post-war economic renewal and prosperity.

The Uruguay Round is the most ambitious and complex Round of negotiations conducted under GATT auspices. The GATT has been very successful in lowering tariffs and other trade barriers among the industrial countries. The Uruguay Round is seeking to resolve old problems such as agricultural and textile trade issues and the negotiations are addressing new issues including trade in services, trade-related investment measures and intellectual property issues. Proposals are under consideration to strengthen the trading system through reform of the GATT dispute settlement processes and developing new mechanisms to monitor national trade policies. Not only is the agenda for the Uruguay Round ambitious, but many more countries, including many developing countries, are actively engaged in the negotiations.

The International Economics Program has issued a series of discussion papers: From the Tokyo Round to the Uruguay Round by Frank Stone, The Canada-U.S. Free Trade Agreement and GATT by Frank Stone, and Canada's Stake in the Uruguay Round and the GATT System by this author. These discussion papers address specific Canadian concerns and priorities in the Uruguay Round and examine the relationship between the Canada-U.S. Free Trade Agreement and the multilateral trading system.

The papers contained in this issue of International Economic Issues are drawn from seminars held by the Institute in Vancouver on November 10 and in Toronto on November 29. The commentary by John Curtis provides a concise overview of the Uruguay Round agenda in light of Canadian objectives and priorities, while Bill Miner examines one of the most contentious issues for the Montreal meeting and the Uruguay Round, resolving differences over agricultural trade.

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The final two commentaries provide complementary perspectives on U.S. trade policy and the implications for the Uruguay Round. The presentation that Marc Levinson made on November 10 in Vancouver was delivered amidst the Canadian election campaign and uncertainty about the prospects for implementation of the Canada-U.S. Free Trade Agreement, but his analysis of the domestic pressures on the trade agenda of the next administration provides the flip side to Jeff Schott's analysis of the U.S. negotiating agenda for the Uruguay Round.

A common thread that ties these papers together is the economic and political consequences of growing economic interdependence. For better or worse, international trade policy has become woven ever more deeply into the domestic politics of nations, both large and small.

Certainly the influence of domestic politics on international economic relations has been evident in North America. Protectionist pressures in the United States in the 1980s have become a major concern to the global trading system, while the crescendo of Canada's Free Trade Debate has reverberated far beyond our borders.

Perhaps the greatest challenge to the Uruguay Round, however, could come from Europe. As the European Community lumbers toward completion of the internal market by 1992, key issues remain unresolved about the implications of internal liberalization for the external policies of the European Community. If the European Community is inward looking and seeks to remove non-tariff barriers such as procurement preferences on an exclusively European basis, then progress in the Uruguay Round could be difficult. If, however, the European Community is prepared to pursue multilateral liberalization in conjunction with its internal efforts this could facilitate progress in the Uruguay Round. Of course, the balance between internal and external liberalization in the European Community may vary with respect to different issues, but the E.C. drive toward 1992 clearly will interact with the Uruguay Round negotiations.

The challenge for the Montreal Ministerial Meeting and for the final stages of the Uruguay Round is to strengthen the multilateral trading system and to sustain progress in trade liberalization. Meeting that challenge may be more difficult today, but greater economic interdependence means that the stakes for the world economy are greater than they were forty years ago.

December 1, 1988

The Uruguay Round Agenda and Prospects for Montreal

by John M. Curtis*

The Uruguay Round, almost half-way through in terms of the 1990 end-date established by Ministers in the Punta Del Este Declaration, is very large and very complex - its agenda is the most comprehensive and ambitious in the history of the GATT. At stake in this Round is a crucial element of our future prosperity, an effective and up-dated system of trade rules and disciplines, and the future of multilateralism itself.

To put the current Round in perspective, let me remind you that there have been seven Rounds since 1947 when the GATT was established with 23 participants, including this country. The first six, through the Kennedy Round of the mid-1960s, focused largely on tariffs. The GATT was successful in reducing, and in a few cases eliminating, tariffs on a very wide basis. International trade, as most of you will know, increased rapidly as a result during this period. In fact, the volume of trade rose every year through the mid-1970s. Trade grew faster than domestic economic activity in almost every country during that long period of post-war expansion.

By the 1970s, faced with major trade and monetary shocks, and with new instruments of trade protectionism devised and increasingly implemented to slow domestic structural adjustments resulting from these unexpected changes, GATT participants undertook a seventh Round, the Tokyo Round. This time negotiations focused on both tariff and non-tariff restrictions on trade, the latter being particularly difficult as traditionally domestic areas of policy became subject to international discussion and negotiation. Further tariff reductions, as well as a number of new

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codes setting out international disciplines standards, resulted from these efforts. The stage was set for the 1980s and for the current Round.

The Uruguay Round, and the momentum leading up to it, can be summarized very briefly. Notwithstanding the progress made in the previous Rounds, the rules and institutions of the international trading system were clearly falling behind developments and practices by individual countries and regional groupings. GATT and the international trade system it oversaw began to lack credibility in the eyes of both some governments and the private sector in many countries.

Important sectors of economic activity such as agriculture and services remained largely outside GATT disciplines, while the formation of regional economic groupings, the coming on to the international scene of major new exporters, particularly in the Pacific Rim, the increased use of grey measures sometimes clearly outside GATT rules, and the increased resort to unilateral measures particularly by the USA, characterized the trading system of the early 1980s. All these trade-related factors, combined with rapid, on-going change in the world's technology and with volatile movements in exchange rates, meant that stability and predictability in the world's trading system -- critical to long-term innovation, investment and trade - were becoming increasingly undermined. The basis on which post-war prosperity and growth was built was becoming unstuck. Very pessimistic predictions for the future were beginning to be heard increasingly frequently, especially following a rare Ministerial-level meeting of trade ministers late in 1982 where little progress was made on developing a consensus for a renewed effort towards global trade liberalization.

By 1986, there was sufficient awareness of the collective stakes involved that the world's leaders - and more particularly their trade ministers - were in a position to agree at Punta Del Este on launching a major new Round. There were recalcitrants at the time and there still are. Certain items were more easily put on to the negotiating table than others, and some issues had a clearer definition, both in negotiating and in substantive terms, than others. Fifteen negotiating groups were established in January 1987 covering:

- access, both tariff and non-tariff barriers in every sector of industry;
- agriculture, including tariff, non-tariff and subsidy questions;
- so-called "new issues" - services, trade-related intellectual property matters and trade-related investment measures - which are not currently covered for all intents and purposes by the GATT but are of central importance to the growth of world trade and output;
- and institutional issues - including, on the one hand, trade remedy laws and, on the other, systemic issues.

With respect to the first group of issues, subsidies/countervail, anti-dumping and emergency import protection or safeguards, let me remind you that the abuse or violation of these trading rules has been a major and continuing source of protectionism and protectionist pressure generating uncertainty and thus inhibiting growth, investment, and trade. With respect to systemic issues, what is involved includes the upgrading and strengthening of the GATT as an institution to mirror more closely the Bretton Woods bodies, the International Monetary Fund and the World Bank, so that trade is no longer the weak link in the chain of international economic interdependence. Central to the effort to strengthen GATT as an institution is the implementation of trade policy surveillance, the micro counterpart to the Fund's macro

surveillance. This is especially important to have in place as present current account imbalances unwind, thus generating unprecedented structural pressures. In the 19th century, it was said that trade followed the flag: an apt dictum for the 1980s and perhaps the 1990s might well be that protectionism often follows a trade deficit!

Another key systemic issue is a more efficient and effective dispute avoidance and settlement mechanism: clearer rules of the road won't mean much if they are violated with impunity.

Canada is well positioned for this Round. Our trade policy is based on the premise that the best way to cope with interdependence on the trade front is to seek trade opportunities abroad while minimizing our vulnerabilities. To achieve these objectives, we are working through trade negotiations to ensure that there is an effective set of international trade rules. Thus we place a high priority in the MTN on achieving maximum results on market access liberalization so that we can push for enhanced shares of growing markets outside of North America. Thus we need major results, for example, for our natural resource-based products - still of great interest to British Columbia as well as most regions of Canada - where open market access was not satisfactorily achieved in previous rounds and hence where many markets remain protected by escalating tariffs on higher value-added goods. This strategy of optimizing our access targets in both a product and a regional dimension, often in coalitions with likeminded countries, will apply also to the increasingly-important service sectors where Canada, including British Columbia, is more and more competitive and ready to seek new markets.

A key aspect of the Canadian strategy for the Uruguay Round has been, and continues to be, the deployment of coalitions to enhance our bargaining clout vis-à-vis the big players. Indeed, in

more general terms, the far greater involvement of developing countries in this negotiation is a striking feature of the Round and of today's world. The north-south divide is fast vanishing as countries like Korea and the export-oriented Asean group begin to understand that economic weight and economic benefits involve both international opportunity and international responsibility. The export volume of these countries will soon outstrip that of Japan and their policies, both domestic and international, are evolving ---albeit in some cases quite slowly---in the direction of more rapid import expansion. Canada has undertaken to work closely with these groups of countries, with our largest trading partners, as well as with the more moderate Latin Americans on an issue by issue basis to maximize the effective pursuit of our priorities in the Round. While the best known of these single-issue coalitions is the Cairns Group of agricultural exporters (which includes most of Asean, several Latin American exporters, Hungary, as well as Canada, Australia and New Zealand, countries accounting for 25 percent of world agricultural exports), we are making a major effort to contribute across the board - with our partners large and small - in all areas of the negotiations.

Let me conclude with a few words on prospects for the Uruguay Round. The next major milestone in the negotiations is the Mid-Term Review which is coming up very quickly---early next month in fact---in Montreal. Work in all the negotiating groups in Geneva is now very intensive and a series of key ministerial and senior official meetings have recently taken place, or are about to take place, to cover the agenda as a whole in the lead-up to Montreal. At home in Canada, our consultative machinery, both federal-provincial and private sector, has moved into high gear.

The stakes riding on the Montreal meeting are very high. It is a key decision-point for the Uruguay Round negotiations, as decisions taken at the meeting will set the parameters and a

specific timetable for the negotiations over the next two years. Coming as it does just six weeks before the inauguration of the new American administration, and the opening of the 101st Congress, it will have an important determining factor in the future course of U.S. trade policy. The recently-passed omnibus United States trade bill should be read as a signal that protectionism in the U.S. is certainly not dead. It is at best quiescent: the bill offers plenty of scope for "administrative protectionism" in its "super 301" provisions as well as in other sections if the new administration is so inclined.

Further, alternatives to multilateralism - inward-looking bilateralism, sectoral reciprocity, aggressive unilateralism - could become increasingly attractive options should the Montreal meeting be judged a failure. Further, Europeans have warned that they will retaliate against any U.S. action they regard as protectionist. The increasingly sharp transatlantic war of words on bilateral and sectoral reciprocity is unsettling to say the least and might well affect the outcome of the Uruguay Round. Moreover, the administration will begin drafting a Farm Bill in 1989: one needs little imagination to sketch out its main features if Montreal provides a signal that the Uruguay Round is likely to falter in bringing agricultural trade under effective multilateral discipline. A renewed subsidy war could be launched across the Atlantic and we would be caught in the middle once again. The first tentative,but nonetheless remarkable, steps to liberalize Japanese agriculture might well halt as well, should the world-wide momentum for reform be quelled.

So what are the prospects for Montreal? It is - despite the date - too early to offer a firm forecast. The European Communities' position for Montreal, for example, will not be put before its Council of Ministers until nearly the end of November and the United States will not be in a position to finalize its

position until the dust settles after the events of this past Tuesday. So, while work in the various negotiating groups is currently very intensive on key items - on agriculture certainly, as well as on services, intellectual property and access - we will not know the shape of a possible compromise outcome until just before the Montreal meeting or during the meeting itself.

We do know, however, that several subjects will present real difficulties. Amongst them I would place agriculture, intellectual property, textiles, and services. On agriculture, while most major players, including Canada as part of the Cairns Group, have put forward positions touching on both short-term and longer-term agricultural trade distorting and restrictive measures, there is no clear sign yet that the extremes of the USA and European Community positions have been narrowed. The United States offered some widely-reported new ideas on short term agricultural measures at an informal meeting of trade ministers from 28 developed and developing countries in Islamabad just over a month ago. We will see where that takes us, particularly depending on how the Europeans choose to respond. Getting agriculture under effective GATT disciplines is of central importance to Canada. Indeed, without a good agricultural outcome, there will not be a successful Uruguay Round, which would have much broader repercussions for the global economy and for Canada.

With respect to trade-related intellectual property, let me mention only that this issue has emerged as one of the highest USA priorities backed by powerful private sector interests and with strong support from the European Community and from Japan. Major developing countries, concerned about transfer of technology aspects of this question amongst others, are resisting going beyond a review of existing GATT articles and counterfeit issues. These positions mean that a meaningful outcome on TRIPs in Montreal will be very, very difficult.

On textiles, a problem in the international trading system since the late 1950s, we have no clear reading as to how this issue will play out in Montreal. The goal of all of us is an eventual reintegration of the textiles sector into the GATT. But how this is done, and at what speed, will be influenced by, amongst other things, the kind of new safeguards arrangements - the rules that govern how countries can react to sudden surges of "fairly-traded" goods - which may be agreed upon as part of the Round.

On services, a difficult subject both because it is "new" to the GATT process, because it is hard to define - notwithstanding the efforts of this Institute, amongst others, on the subject - and because public policy questions of economic development and public health and safety amongst others are raised, I can be somewhat more definitive. There continues to be concrete progress on various elements of a framework agreement - to incorporate principles such as transparency and national treatment - and we should be clearer by Montreal as to what a framework to cover services might realistically include.

Success in Montreal will require movement across a broad front of other negotiating headings as well - these are just the more difficult ones! Progress, for example, will be needed on institutional issues such as dispute settlement and the functioning of the GATT system - subjects of real interest to us, a smaller economic power interested in effective international rules and institutions to discipline the behaviour of the larger economic powers, even if this means that we have to obey the rules ourselves. Progress in Montreal is also required on the negotiations in tropical products - of deep interest to developing countries, some of whom see little else in the negotiations for them specifically - and on other market access issues where we, as I mentioned above, and other "middle-sized" and smaller countries,

are pressing for further substantial overall reduction of tariffs and NTBs, including total elimination where possible.

Nonetheless, the Montreal Ministerial Meeting is a policy event of fundamental strategic significance and all GATT members appear to be committed to its success. This was confirmed in the communique of the Toronto Summit in June which stressed: "the Mid-Term Review will provide a unique opportunity to send a credible political signal to the trading world" and was repeated again at the informal Islamabad meeting of trade ministers to which I referred earlier. At Islamabad, Ministers gave a clear political signal that a package with something of interest for all significant participants. A time-table and an agenda - a clear negotiating framework - would be agreed upon in all areas of the negotiations to guide negotiators through to the end of the Round in 1990. That, then, is where we should be by the end of this year.

Agriculture and the Montreal GATT Ministerial Meeting: Ending the Trade Wars*

by William M. Miner*

Agriculture is a key issue in the Uruguay Round of Multilateral Trade Negotiations (MTN). It is perhaps at the top of the agenda for the GATT Ministerial Mid-term Review in Montreal. For better or worse the outcome of the Montreal meeting will be judged, at least in Canada, by its success or failure in agriculture. If a means cannot be found to deal with disputes and other problems plaguing world agricultural trade, the Uruguay Round itself may be stalled and ultimately founder.

Bringing Agriculture Into GATT

It is easy to be pessimistic about attempts to restore order and to liberalize trade in farm products. After all, for forty years, governments have largely failed to bring agriculture under the GATT. This is so because governments have been unwilling to accept international disciplines with respect to their domestic agricultural programs. In principle, the GATT rules do apply to all goods entering world trade. But the GATT is riddled with exceptions, waivers and grandfather clauses with respect to agriculture because governments have insisted on retaining the right to take action at the border to protect internal agricultural support systems. They have also retained wide flexibility in the use of export subsidies and other forms of assistance to get rid of surplus production.

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* This paper was prepared for Conferences on **Strengthening the Trading System: Prospects for the Montreal GATT Ministerial Meeting** organized by the Institute for Research on Public Policy which were held in Vancouver and Toronto on November 10 and 29 respectively. The views expressed are solely those of the author and do not necessarily represent the views of the Institute or its members.

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To unravel this situation, and negotiate stronger, enforceable international rules to govern agricultural trade will require that governments place their domestic policies on the negotiating table for all major traded commodities -- at least to the extent that these policies distort or damage trade.

To the surprise of many the 1986 Punta Del Este Declaration that launched the Uruguay Round was successful in committing GATT countries to a negotiation covering both border and domestic policies which adversely affect agricultural trade. Furthermore, governments in the main industrial countries at last seem to recognize that genuine reform of agricultural policies is needed. Indeed, in a number of cases, some reform is already underway. It is generally recognized that it is vastly better to undertake major farm policy reforms together, on a comprehensive basis, in a multilateral trade negotiation. It is also realized that to some extent all industrial countries are "sinners" and the negotiations will fail unless they are all prepared to share in the adjustment process. Hence for the first time it is possible to be cautiously optimistic about the prospects for agriculture in the GATT Round.

The Free Trade Agreement - Will It Help?

In the Canada-U.S. bilateral trade negotiations, agriculture was also important. Although the Free Trade Agreement (FTA) stops well short of creating complete free trade in this sector, it includes a number of significant changes which could affect the multilateral trade negotiations in agriculture. Some of the results for agricultural trade are quite far-reaching such as the gradual removal of all tariffs, a prohibition on export subsidies, agreements on technical standards and new institutional mechanisms to avoid and resolve trade disputes. It was never realistic to expect either government to accord national treatment to each others products with respect to its trade remedy laws. Both the United States and Canada could be expected to insist on the right

to protection from subsidies and dumping which injure domestic producers as provided for in the General Agreement on Tariffs and Trade (GATT). However, the creation of a binational panel to provide for binding arbitration of the application of domestic antidumping and countervail legislation and general panels to resolve other disputes is a unique accomplishment.

The negotiations were unable to deal with agricultural subsidies which are central to most of the U.S.-EC trade wars that we are witnessing and to most of the agricultural trade disputes between Canada and the United States. This is the key agricultural issue in the MTN and the two governments have agreed to work towards establishing a new system to address the trade problems arising from subsidies. The agreement not to directly subsidize agricultural exports to each other's market is the first of its kind.

The agreement to build on the GATT Standards Code to reduce technical barriers to trade is particularly important for Canada-U.S. agricultural trade. It will strengthen bilateral co-operation between regulatory authorities to reduce technical differences that affect trade and should contribute to the negotiation of more effective multilateral disciplines. As the current dispute between the United States and the European Community over the use of growth hormones in beef demonstrates, these technical issues can grow into full scale trade wars in the absence of precise and transparent international rules and effective dispute settlement procedures.

These aspects of the bilateral Agreement are likely to have some influence on the MTN. Of course, a failure to proceed with the FTA would have created new uncertainties regarding the Uruguay Round and Canada's position at the Montreal Ministerial Review. It would have required that Canada refocus its negotiating strategies on obtaining access to the United States market which

is particularly important for Canadian exports of livestock, red meats, oilseed products, some horticultural goods and a wide range of semi-processed and fully processed farm products. With the FTA moving ahead following the Canadian election, attention can focus on access to other markets in addition to pursuing strong disciplines on subsidies and effective dispute settlement procedures.

The multilateral negotiations on subsidies, access and dispute settlement procedures are crucial for Canadian agriculture. The GATT does provide a set of rules, however inadequate these have been, that govern Canada-U.S. trade in agricultural products. These include dispute resolution procedures which are being used to settle agricultural trade differences. However, governments have largely failed to develop effective trade rules for agriculture and this is a serious deficiency. With a small domestic market and much slower growth in demand projected for traditional farm products, the Canadian agri-food industry must rely increasingly on the United States and other export markets for expansion. The FTA will be helpful in discouraging U.S. protectionist pressures and limiting unjustified actions to restrict Canadian imports. Nonetheless, Canada is likely to face additional challenges to its exports to the United States of those farm products which benefit from subsidies. Both governments will work to develop and implement a substitute system of countervail and antidumping laws within seven years. They have also agreed to work together in the MTN to achieve the elimination of all subsidies that distort agricultural trade. A stronger trading system and international trade rules that work effectively have become indispensable for Canadian agriculture.

The Direction of Reform[1]

There is broad agreement among policy leaders on the nature of the global problems that affect world agriculture. In most developed countries there is excess capacity in agriculture and the potential to produce much more. Many government policies have encouraged extra resources into the industry and discouraged the adjustments that are needed. These policies often increase production and some depress consumption. Many farm subsidies are designed to offset the losses created by other programs, particularly the policies of other industrial countries. Most agricultural policies tend to be inflexible and do not respond adequately to either long or short supply situations. Efficient exporters in both developed and developing countries may be forced out of production in severely depressed situations and become unable to respond to shortages. Thus, farm policies often contribute to the problems they are designed to resolve. Government treasuries are competing in export markets. Trade wars have erupted that damage markets and endanger the multilateral trading system. Taxpayers and consumers must cover the costs of support and often farm incomes are not being maintained. Of course there are winners and losers in every country but policy reforms have become increasingly necessary.

There is considerable agreement embodied in successive statements of OECD Ministers and by Summit country leaders on the desirable direction of policy change. All industrial countries are to some extent guilty of protecting and supporting agriculture in ways which distort world trade and harm the interests of other countries. The agreed option is to shift policies away from commodity based support and towards a more market-oriented

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1. For a discussion of agricultural policy reform see World Agricultural Trade: Building a Consensus, The Institute for Research on Public Policy, Ottawa, Canada, edited by W.M. Miner and Dale Hathaway, (ISBN-88645-071-3).

agriculture. If countries proceed unilaterally to respond to budget pressures and internal policy conflicts, the adjustment problems are often pushed on to other countries and become more severe. As it is much easier and less costly to adjust food policies in a comprehensive process which gradually reduces border restraints and subsidies that distort trade, the key trading countries have agreed to pursue these issues in the Uruguay Round.

There is not yet a clear consensus on the interests of developing countries in these new approaches. Since most discriminate against their agriculture, excess capacity is generally not a problem. In many of these countries, agriculture which is their major industry, is taxed or otherwise disadvantaged to finance general economic development or government services and to keep food costs down. In addition, the economies of developing countries are seriously harmed by the trade protection and subsidy practises of industrial countries. Admittedly, the net food importers often benefit from lower world market prices in the short term, and this advantage could be somewhat eroded by freer trade. However, their agriculture suffers by having to operate in a distorted domestic and world market and in competition with the subsidies provided by wealthier countries.

Unfortunately malnutrition continues to be a widespread problem and the harsh reality of starvation persists in some areas. But general economic policies, inadequate development opportunities and poverty are at the root of these problems. Agricultural policy reforms and trade liberalization will contribute to their resolution, particularly if combined with development aid. However, measures by the international community to promote economic growth and alleviate poverty are much more important to attack the root causes of malnutrition.

There is less international agreement on the long-term objectives of farm policy reform. The United States is advocating free trade in agriculture and the virtual elimination of government interventions. Thus all U.S. policies including their GATT waiver will be placed on the negotiating table, provided other countries will do likewise. The United States would eliminate all policies that directly or indirectly affect trade apart from aid programs, direct support which is decoupled from production and marketing programs that provide safety net protection. They propose the negotiations of GATT rules and disciplines consistent with free trade principles. This will mean that U.S. programs in the more sensitive sectors such as dairy, rice and sugar will be on the table. Although this proposal is extremely ambitious and there is scepticism that it commands the full support of all major agricultural groups in the United States or that Congress would go this far, it does provide a clear goal for the negotiations.

The Cairns Group of thirteen agricultural exporters, including Canada, generally endorse the U.S. approach but leave room for the maintenance of farm programs that have limited effects on trade. These countries propose that there should be an immediate freeze of agricultural protection and subsidies which distort trade and a commitment to implement reductions in 1989 and 1990. This would be followed by a program of systematic reduction in trade-distorting support and protection combined with the negotiation of transitional and permanent GATT rules to police world trade.

The European Community is prepared to undertake substantial reductions in agricultural supports that inhibit trade contingent upon early steps to stabilize markets and to harmonize support and protection among sectors. The Community wants to retain some protection for its farmers from world market forces including the flexibility to operate two-price systems. While the Community will consider a freeze and a process of reductions, it has not yet

proposed more specific long term directions. Thus, so far, the Community has not committed itself to negotiate on the fundamental principles of the Common Agricultural Policy (CAP).

Japan is playing a much more positive role in these negotiations while emphasizing it's need to secure access to foreign supplies and to protect the special characteristics of parts of its agriculture, notably rice production. Under pressure, the Japanese have made considerable strides to liberalize certain food import regimes. The Nordic countries and Switzerland are also prepared to liberalize their agricultural trade, but they want to continue to manage the flow of supplies, including imports. The European countries and Japan also place emphasis on the negotiation of stronger GATT rules and disciplines.

The developing countries generally support freer trade since in many ways these countries are the largest losers from the current situation and have the most to gain. But those which depend on food imports emphasize the importance of international market stability and the need for international assistance to develop their agriculture and to secure adequate food supplies from abroad. The developing countries stress the importance of improved access, particularly for tropical products and a number are active participants in the Cairns Group.

So all countries support a move to freer trade in agriculture based on a gradual reduction in trade-distorting measures and improved GATT rules. They differ on the pace and depth of reforms and the role of governments in providing support and protection to farmers from the instability of markets and from international competition. However, the negotiating proposals envisage the continuation of various forms of general support to agriculture to

achieve structural, environmental, regional development or income objectives and to provide safety net programs to reduce market and income instability.

While the impasse continues between the United States and the European Community over the long-term objectives of reform, the direction of policy change seems to be agreed. And in many countries it is already underway. The United States has adjusted policies to hold some excess resources out of production and to lower support prices toward world market levels. The European Community has also taken important decisions to reduce surplus production by limiting expenditures and reducing support through the "stabilizer" mechanism. The first acreage set-aside program under the CAP has been approved. Many developing countries are liberalizing trade, reducing exchange rate distortions and bringing prices more in line with world markets as part of debt restructuring programs.

Has the Drought Diminished Prospects?

One element of the policy equation has changed dramatically over the summer. The severe drought in North America, and reduced harvests elsewhere, has turned the world grain surplus into modest reserves. The FAO has warned that global food security is at risk. There is enough grain to go around but it is not all where it is needed and no one knows what the weather will do to crops in 1989. These developments have reduced the need for immediate steps to deal with surpluses and market imbalance but have not affected the underlying policy issues.

Although those who resist changes in farm policies can now argue more strongly that the incentives to produce must remain, bad weather is not an excuse for bad policies. If the markets are short, more flexible policies will encourage farmers to respond to greater demand. If policies remain unchanged, and the weather

returns to normal, supplies will once more exceed demand and the downward price spiral will begin again. And each time this occurs the problems become more severe and the adjustments more costly. As emphasized in a Policy Statement released by twenty-nine professionals from seventeen countries in Ottawa last May[2], delay would be a major error. If markets are improving, the changes can be made more easily. If the improvements are temporary, policy adjustments become even more necessary. The focus of policy reform is the 1990s. Changes in whatever form will have to be gradual and policies should respond to market signals whatever the nature of the harvest. This statement makes a number of specific recommendations for both short and long term reforms in agricultural trade policies. It was an international initiative designed to help governments develop a global consensus on these difficult issues.

Free Trade or Managed Markets

Many people continue to argue that free trade in agriculture is not a realistic option at least in this Round. They point out that Governments have been pursuing this objective for many years in GATT for other goods, and have still some way to go. Although some consider that freer trade will undermine food security, most of the evidence indicates that world markets will become more stable and farmers will better respond to market needs if systems are more flexible and open. However, governments are unlikely to leave their sensitive food policies entirely up to market forces despite the apparent consensus that a major shift in that direction is needed.

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2. **Reforming World Agricultural Trade: A Policy Statement by Twenty-Nine Professionals from Seventeen Countries, The Institute for Research on Public Policy, Canada and the Institute for International Economics, Washington, May, 1988 (copies are available on request).**

But neither is the management by government agencies of agricultural production and trade a viable long term option. Farm policies, regardless of their nature, must be responsive to national and global trends in production, consumption and trade. Many governments have moved in the last decade to increase the role of market forces in agriculture in order to lower costs, remove distortions in resource use and stimulate diversification and development. China is an outstanding example of a country which has gained enormously in its agriculture by loosening state controls and freeing up internal markets. In recent seminars involving many countries in Africa organized by the Institute for Research on Public Policy at the initiative of the Canadian Government, several representatives referred to the tough but necessary steps that African countries are taking to reduce state interventions, liberalize trade and stimulate their agricultural sectors. There are numerous examples of a shift in policies toward greater flexibility and market orientation in industrial, developing and centrally planned economies.

However, most countries are likely to insist on maintaining a degree of capability to intervene in the food sector at least until an acceptable level of agricultural or rural development, food security and market stability is achieved. For most developing countries, a vigorous agriculture is essential for economic growth. Although food security does not require self-sufficiency, the expansion of agriculture on an economic basis will contribute to higher incomes and strengthen these countries capability to acquire adequate food from domestic production and imports. Importing countries must be satisfied that their access to foreign supplies is secure. The acceptable mix of policies will differ among countries depending on their resources and farm structures. But it would be unacceptable to move forward with farm

policy reform and trade liberalization without ensuring that the problems of malnutrition and hunger are not aggravated by this process.

Adjusting policies towards greater market orientation does not require that all existing programs be dismantled nor that farmers incomes be left entirely to market forces. National agricultural services such as research, grading, extension, food aid and assistance from natural disasters do not distort trade. Similarly, most framework measures providing for rural development, conservation and environmental improvements, general infrastructure assistance and direct income transfers are trade-neutral. Programs providing for stabilization, resource inventories, orderly marketing and income insurance have limited effects on trade provided they are actuarily sound and geared to longer term market clearing levels. It is the programs that provide price and income support based on commodities and direct trade measures to restrict imports and subsidize exports that are primarily responsible for the distortions and trade difficulties. For both national and international reasons, these policies should be modified. Differences are likely to persist over the extent and speed of agricultural policy reform but it is extremely important to begin a multilateral process. In addition, the negotiation of strong and enforceable GATT rules and disciplines are essential to give governments confidence that mutually agreed policy adjustments are secure and to avoid the recurrence of serious trade conflicts.

Developments over the past decade indicate that agricultural policy reform is moving in the direction of gradually linking domestic and world markets so that producers and consumers in all countries will take part in the adjustments to international market conditions. Increasingly this is being accompanied by replacement

of market interventions by other forms of structural, regional and environmental support and farm safety net programs that do not distort production and trade.[3]

Prospects for Agriculture in Montreal

Some progress has been achieved in finding common ground in the count-down to Montreal. The Cairns Group proposal of an immediate freeze of all import restrictions and trade distorting measures to be followed by an agreement to reduce such measures by 10 percent in each of the next two years is being seriously considered. A freeze would represent a significant advance as support prices, export subsidies and government expenditures have declined as a result of stronger markets and policy adjustments in some countries. It should improve the political will to avoid trade disputes.

It is extremely important to take the first step in the process of reform by agreeing on the policies that must be subject to negotiations, a formula or across-the-board measure for negotiating reductions in their trade effects and an initial reduction. This would give clear directions for policy change and provide concrete evidence that governments are taking steps on a multilateral basis to reduce agricultural trade problems. The approach of using an overall aggregate measure of support (AMS) provides a way to deal with the complex range of policy instruments that adversely affect farm trade. Provided it is used as a negotiating formula and interpreted in a realistic manner to deal adequately with the most distorting policies and to exclude programs that have little or no effect on trade, it should facilitate the negotiations and make the results more equitable.

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3. **World Agricultural Trade: Building a Consensus contains an illustrative list of agriculture policy instruments arranged according to their purposes and relative effects on trade.**

It avoids the request and offer procedures and the commodity by commodity approaches that have not proven productive in the past. It treats access and subsidy issues together as these are linked and difficult to negotiate separately. It provides the maximum scope for involving many countries in the actual negotiations compared with the traditional means of bilateral negotiations between the principal suppliers followed by negotiations to accommodate the interests of other trading countries.

Agreement to a negotiating target expressed as a reduction in the AMS would be followed by commitments by each country to make specific policy changes over a period of time. In this context, Canada proposes that an adjustment be made in the AMS calculation for programs which effectively limit the output eligible for direct or indirect income transfers. These commitments would be accompanied by an agreement to establish new arrangements in GATT to monitor the fulfilment of undertakings and to resolve differences.

Perhaps of the greatest significance, and the reason the AMS is an attractive concept to the Europeans, it offers flexibility in the choice of domestic policies depending on their influence on production and trade. The United States and the Cairns Group have viewed the AMS as a means of establishing negotiating targets and of monitoring the fulfilment of commitments that would be expressed in terms of policy changes. Recently, the United States has proposed that all non-tariff measures be converted into fixed tariffs which is an alternative means of negotiating reductions in protection.

The Montreal meeting should also provide guidance to delegations with respect to the negotiation of stronger trade rules for agriculture. The objective should be to apply the rules progressively to agriculture both with respect to access

(Article XI) and subsidies affecting trade (Article XVI). This would bring all policies currently not covered by GATT articles under international disciplines. It would involve the removal of waivers such as the U.S.waiver, grandfather clauses where legislation pre-dates the GATT and protocols of accession that provide for special exceptions. The provisions of rules affecting market access, particularly Article XI, should be clarified and strengthened in order to contribute to trade expansion and the gradual removal of quantitative restrictions and other non-tariff barriers. The conversion of non-tariff barriers to tariffs and the negotiation of reductions as proposed by the United States is one means of achieving this objective. These disciplines must be applied to all border restraints including variable levies and state trading operations. Minimum import commitments and their gradual increase could be negotiated as a means of progressively applying GATT rules to agricultural trade and bringing domestic prices closer to international levels. Ideally, export subsidies should be prohibited or removed within an agreed time-frame. Other indirect subsidies affecting trade should be reduced and placed under international disciplines.

However, the acceptance of a package of policy adjustments in the form of a "down payment" in Montreal will depend on reaching agreement on long term policy reform. So far, this agreement has not emerged. The United States is insisting on firm commitments to the eventual removal of all trade-distorting measures. The European Community has rejected this position and has been unwilling to set out its own long term objectives for reform.

The newly formed International Policy Council on Agriculture and Trade met in Montebello in late September to review these issues and offered suggestions to the negotiators on agriculture for the mid-term review. It is headed by Lord Plumb, President of

the European Parliament and a former President of the National Farmers' Union in Britain. The Council currently includes twenty-six policy experts from sixteen countries.*

The Council was formed to bring together an independent group experienced in trade, finance and policies related to agriculture in order to develop recommendations for resolving global agricultural problems. The group consists of individuals from governments, agri-business, international organizations, farm groups, banking and academia, from both developed and developing nations. It is not sanctioned by any government, and meets formally twice yearly.

At its meeting in Montebello on September 21-24, the Council set out the following suggestions to governments for agriculture in the Mid-term Review[4] which provide a summary of the issues under consideration:

- an immediate freeze of trade affecting support at current levels and an agreement on an initial reduction of such support to be achieved within the next two years;

- longer term policy reform involving the linking of domestic and world markets to facilitate the transmission of market signals, thus bringing every country's producers and consumers to participate in the adjustment to international market conditions;

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* The Secretariat is located in the National Centre for Agricultural Policy, Resources for the Future, Washington, D.C. Two Canadians are currently members of the Council: Lorne Hehn, President of United Grain Growers in Winnipeg and the author.

[4] The text of the Communique of the International Policy Council on Agriculture and Trade, Montebello, Canada- September 24, 1988 is available from the IRPP on request.

- reform should equally involve a graduated replacement of market interventions by other forms of social, structural, environmental or regional support that are unrelated to production;

- during the remainder of the Uruguay Round governments should agree to at least a 50 percent across the board reduction in trade distorting support over a fixed period;

- strengthen, simplify and make transparent GATT rules and disciplines, particularly with regard to access and trade distorting subsidies and taxes, so that fundamental GATT principles apply more fully to agriculture;

- access to markets and supplies must be increased entailing a progressive reduction of subsidies and of import and export restrictions and a prohibition of all embargoes;

- strengthen significantly the surveillance and dispute settlement process in the GATT and establish a mechanism to monitor commitments on domestic policies and to compare the policy developments to the commitments; and

- the active participation by developing countries in GATT negotiations should be vigorously encouraged so that their special interests are taken into consideration.

It is to be hoped that governments at Montreal will be prepared to go as far as the Councils' suggestions. The United States appears ready to agree to a freeze provided all GATT countries will commit themselves to eliminate policies that affect trade over an agreed period of time. However, U.S. farm groups will be reluctant to forego policy flexibility following last years shorter harvest unless a major breakthrough can be achieved in reducing subsidies and protection elsewhere. The Community claims that it is not ready to entertain specific long term commitments although there are indications that a freeze and some first steps in reductions are possible. The Cairns Group are pressing strongly for a robust framework agreement on agriculture that will carry the negotiations to a successful conclusion by 1990. These countries have a great deal to lose from a failure in Montreal. Their exports have been severely harmed by the chaotic conditions in

world trade and they are unable to compete with subsidies. The Cairns Group is receiving considerable support from Japan, the Nordic countries and a number of developing countries all of whom have a significant interest in preserving and strengthening the multilateral trading system. The outcome remains uncertain but the stakes are high. What seems essential for Montreal is strong direction from Ministers to their negotiators to create the framework and momentum necessary to achieve a successful result by 1990.

The Longer Term Outlook

Looking towards the 1990s and regardless of the outcome of the Montreal meeting, it would be a mistake for farm groups in Canada or elsewhere to assume that adjustments in agricultural policies are not needed. As demonstrated by the results of the Canada-United States trade negotiations, there are changes that can be made that should lead to a more competitive and export-oriented agriculture and food sector without discarding the fundamental elements of Canadian farm policies. But the subsidy problems remain and must be resolved or the future of agricultural trade is in jeopardy. If our main trading partners are prepared to accept a multilateral program of reforms, Canada as a major exporter of a wide range of farm commodities and foodstuffs, should certainly benefit. While this may increase the rate of adjustments in the more protected sectors, in most cases these changes are inevitable. It is extremely important for Canadian agriculture to adjust gradually on an internationally competitive basis if it is to continue to expand.

However, a successful negotiation will not be achieved if key trading countries, including Canada, refuse to negotiate on the trade effects of some of their domestic farm programs. The alternative is a continuation of unilateral policy moves, as the process of adjustment to international market conditions will occur

over time in any event. And inevitably major sectors of Canadian agriculture will be disadvantaged. In the United States, the 1985 Farm Bill is seen to have achieved its objectives with respect to agricultural exports notwithstanding the internal adjustments that have occurred and its harsh impact on many farmers elsewhere. The United States is preparing to write its 1990 Farm Bill and it will be greatly influenced by the success or failure of agricultural trade negotiations. A failure to move the multilateral negotiations forward in Montreal will discourage the positive reforms that are beginning in Japan and elsewhere and feed protectionist forces around the world. The economies of many developing countries which depend on commodity exports will be further harmed. The European Community is developing a unified internal market by 1992 and many are concerned that this powerful economic entity may turn inward. Obviously success in moving toward freer trade in all goods and services will influence the process of economic integration in Europe.

A successful framework agreement on agriculture in Montreal would provide the basis for negotiating reductions in all measures which distort and limit agricultural trade. To succeed it must be applied across the board by all participating countries for all major traded commodities. The insistence on exceptions or waivers by any country is likely to cause the negotiations to founder. Of course, exceptional treatment for developing countries may be provided, depending on their circumstances.

General programs of support to Canadian agriculture which are not targeted on specific commodities or related directly to trade are unlikely to be affected by the negotiations. The approach should not prevent the continuation of safety-net programs for income stabilization and the management of supplies to reduce instability and to support incomes provided they do not distort production and trade. Obviously, the adjustment must be gradual,

and tailored to the needs and prospects of each sector and governments must assist with the transition. Trade negotiations offer the opportunity to do so in a manner which increases the benefits of trade overall, spreads the costs among many trading nations and provides a multilateral framework of rules and disciplines to facilitate orderly change and greater market stability and security. Farm organizations benefit by involving themselves in the process, understanding what is going on and the parameters of a possible result and assisting the Canadian negotiators to identify objectives and strategies in the Round. The Canadian agricultural industry will benefit from a successful Uruguay Round that results in a major reduction in import barriers and subsidies which distort trade and the negotiation of effective international trade rules and dispute settlement procedures.

PROSPECTS FOR U.S. TRADE POLICY:

COPING WITH INTERDEPENDENCE?*

by Marc Levinson

It is difficult for an American to comment on trade issues in Canada during the waning days of an electoral campaign in which trade is the major issue. In self-defense, I wish to issue a disclaimer that nothing in the following remarks should be construed as an endorsement or rejection of any political party or candidate, real or fictitious, living or dead. I have already cast my last ballot for 1988, and having endured our own rather offensive electoral battle I see no reason to become embroiled in yours.

Given the campaign fever here, though, the subject of U.S. trade policy may draw a bigger crowd in Canada right at the moment than in the United States. As you are undoubtedly aware, George Bush's views on trade matters, to the extent he has any, proved to be of little influence in the election campaign just past. That should give you some clue to the future.

Claiming to know the future of U.S. trade policy, of course, is about as presumptuous as predicting what's going to happen in the stock market over the year to come. On that subject, most economists would hasten to inform you that the market is a random walk. That means, they would tell you, that the best guess as to what it's likely to do in the months ahead is what it has done in the months just past, and deviations from that pattern are random

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* Based on an Address to the Institute for Research on Public Policy. Marc Levinson is Editorial Director of the Journal of Commerce and is co-author of **After Reagan: Confronting the Changed Global Economy.**

movements about which no forecasting method can give you a special clue. Personally, I am not sure that stock markets move in a random walk, and I am pretty sure that political trends do not. Nonetheless, the conclusions of the random walk theorists have something to be said for them. What we've been seeing on the trade front in the months just past in the United States is, I think, as good a predictor as anything of what we are likely to in the months ahead.

The United States political system, not to mention the average American voter, is exceedingly tired of hearing about trade problems. It's been a wonderful decade for those of us who make our livings thinking about the international economy. Combined, imports and exports as a share of the United States economy have risen from about 10% in 1978 to 15% today. Foreign trade issues have been on everybody's mind, and there has been lots of work available for editorial writers, economics professors, policy analysts, and the well-compensated members of the trade bar. Those days, alas, are over for most of us, although the trade bar, judging from the number of requests for protection now under consideration in Washington, is still doing pretty well.

Congress spent four years struggling with the trade bill of 1988, and no one on Capitol Hill even wants to thing about the next one. The public, too, has had enough. Witness the fact that trade was a non-issue in this year's presidential campaign. When two associations of rice producers asked the United States Trade Representative on September 14 to retaliate against Japan's admitted barriers to rice imports, they received little public sympathy. Clayton Yeutter's October 28 decision to reject the petition generated no outcry, save from congressmen representing rice-growing districts. The rice producers' attempt to use the impending presidential election to force Mr. Yeutter's hand worked against them: Although both Mr. Bush and Mr. Dukakis issued pro-

forma endorsements of further investigation, the election campaign made clear that trade isn't such a big deal any more, and Mr. Yeutter took full advantage of that lack of interest in acting,wisely, I believe, to quash the rice complaint.

This growing public and political disinterest notwithstanding, the second safe bet about future U.S. trade policy is that the rhetoric from the administration will be louder. It's widely recognized that the Reagan Administration committed a major political error by not being seen to take seriously complaints that imports were damaging U.S. companies or that U.S. exports were facing unreasonable barriers abroad. By assuming far too low a profile on a matter of public concern, the administration left a vacuum that members of Congress were forced to fill.

Everyone in Washington, including everyone in the Congress, is fully aware that the legislative branch has a much tougher time resisting protectionist pressures than the executive branch. If they are to fend off constituents' demands for protection, members of Congress must be able to assure them that the administration will examine seriously whatever problem they face due to foreign competition. Expect more aggressive criticisms of other countries' trade practices from members of Mr. Bush's cabinet and, every once in a while, a conscious decision to turn some otherwise routine trade dispute into a cause celebre.

Although the rhetoric may be louder, that does not mean that Mr. Bush's administration will act in a more protectionist fashion than Mr. Reagan's. It would be hard-pressed to do so. Despite its ideological commitment to free trade, the Reagan administration proved to be the most protectionist U.S. government since the days of Herbert Hoover. The political ineptitude of Mr. Reagan and his associates in dealing with trade and exchange rate problems led to pressures that forced this anti-protectionist government to protect

autos, steel, machine tools, wood products and a host of other industries. If Mr. Bush's administration is a bit louder with its bark, it may find itself relieved of the need to bite quite so often.

To the extent that it does bark, much of the noise will concern purported barriers abroad to U.S. trade policy, and the heart of that consensus is that the major goal of U.S. policy should be to open markets abroad. So-called "unfair" imports are no longer the focus of attention. The 1988 bill marked the first time in three decades that the Congress enacted major trade legislation without making it easier for U.S. companies to prove they have been injured by imports, that those imports are subsidized or that the foreign manufacturer is dumping them in the United States.

Instead, the bill's emphasis is on encouraging -- but not requiring -- U.S. retaliation against countries that impose barriers to U.S. products, as well as against countries that fail to protect patents, copyrights and trademarks. The way the law is written, it puts a premium on political savvy. If the new administration plays its cards right, it will regularly denounce trade barriers around the world, sporadically impose sanctions against the most egregious examples and find itself relieved of the pressure for further action.

The key question here is whether retaliation will be limited to cases in which foreign barriers violate international understandings such as the General Agreement on Tariffs and Trade, or whether the United States will also strike back against barrier that may be deemed "unfair" even though they violate no international rules. The new law allows retaliation of either sort. My guess is that Mr. Bush will be reluctant to retaliate against perceived "unfairnesses" that do not contravene international

commitments. His advisers are well aware that if others start striking back at U.S. policies that they consider unfair, the United States, which needs to turn its $130 billion trade deficit into a $40 to $50 billion surplus over the next few years, could emerge the loser.

But there will be pressures to impose sanctions against foreign barriers in several areas not adequately dealt with in international accords. One is protection of intellectual property. The United States recently raised tariffs on a variety of Brazilian goods due to Brazil's failure to protect the pharmaceutical patents of U.S. firms, and over the past year it has wielded a heavy club against several Asian countries that have permitted infringement of intellectual property rights. Another is barriers to U.S. investment, particularly in those countries whose citizens are active investors in the United States. Worries about the extent of foreign direct investment in the United States are not likely to abate so long as large U.S. trade deficits provide citizens of other countries with dollars to invest, and the fact that U.S. companies face far higher legal or systemic hurdles in investing in foreign markets than foreigners do in investing in the United States has not gone unnoticed. Those who believe Mr. Campeau will be allowed to buy up every department store in the United States may be in for a surprise. The third area in which there will be considerable pressure for a more activist U.S. policy concerns policies that have the effect of hindering trade in a major way, even if they don't violate international rules. Japan's "big store" law, which makes it difficult to establish new marketing channels for imports, is one example here; the European Community's prohibition of hormones in meat products is another. Policies ostensibly required for cultural protection obviously fit under this category as well.

Wish as he might to relegate trade issues to the back burner, Mr. Bush will have to deal with some very difficult problems almost immediately upon taking office. These concern several industrial sectors that have been the beneficiaries of longstanding protection. The administration's actions will offer important clues as to its approach to trade policy in general.

The first of these is steel. Back in 1984, President Reagan granted five years of protection to the basic steel industry in return for a modernization program that was supposed to nurse the industry back to health. By now, 17 nations plus the European Community have signed agreements to restrain steel exports to the United States "voluntarily", while others, such as Canada, are voluntarily restraining their exports so they won't have to sign agreements. This five-year plan expires next September, but the basic steel industry, which sometimes seems to expend more effort seeking protection than it does making steel, is in the midst of a massive public relations campaign to persuade the public that five years of protection is not enough.

This is a tricky one. If the new administration refuses point blank to extend the steel program, Congress probably will. Just to make sure, the steel industry has a stack of anti-subsidy, anti-dumping and escape clause complaints ready to file as soon as the voluntary restraints come off. On the other hand, extending the steel program makes a mockery of the notion that protection can be used to give an industry "time to adjust". Yes, the steel industry in the United States has become more efficient over the past few years, largely by closing down its most outmoded plants, but its furnaces remain old by world standards and there's simply no way U.S. firms can complete with modern plants in Korea, Taiwan, and a dozen other places. Nor will extending quotas do much for Big Steel, since advances in mini-mill technology are likely to eat away at basic steel's core businesses over the next few years even

if imports don't. There will have to be some sort of new steel program. If Mr. Bush is smart he'll keep it short, increase the allowable level of imports of raw steel to promote steel finishing industries, and put a big emphasis on worker retraining.

A second industry that's likely to tie the administration up in knots next year is telecommunications. Here, a complicated issue of international trade has gotten bound up with a complicated issue of domestic deregulation. The regional companies that operate local phone service, the so-called Baby Bells, want the right to expand into new fields, including equipment manufacturing and the provision of information services. Right now, the court order that broke up AT&T prohibits them from doing that, but the Baby Bells would like Congress to overrule the court. Enter organized labor, which has put forth the idea of a tradeoff: It would support broader rights for the Baby Bells if they would accept a provision establishing a domestic content requirement for telecommunications equipment. Will the Bush administration accept a domestic content law in return for deregulation that it wants badly? Stay tuned.

A third sensitive area is that old perennial, textiles. The current incarnation of the Multifibre Arrangement expires in 1990, but the omnipresent textile and apparel lobby will be laying the political groundwork for renegotiation next year. Much as I'd like to see the textile trade opened up, I regard that as unlikely. But I would mention two likely changes in U.S. policy here. One is that we're likely to see heavy U.S. pressure upon other industrial nations to import more textiles and apparel from the developing world. There is a perception, not without foundation, that the United States relative willingness to open its market is not matched by others, and that issue will be raised loudly. The other change in the textile sector concerns Mexico, which, on the advice of the World Bank, wants to get into clothing manufacturing in a big way. Given the great concern about and sympathy for Mexico in

the United States, that country is likely to get a bigger share of U.S. import quotas.

The fourth area that's high on the agenda is agriculture. Agriculture is a crucial issue in the GATT talks. The issue has particular political urgency in the United States, because our existing farm legislation expires in 1990. The drafting of the 1990 farm bill will begin next year, and unless the administration is adept at dealing with concerns about agricultural trade and foreign subsidies it may find itself having to swallow provisions that would make a new GATT agreement on agriculture difficult. There is bound to be a lot of noise on farm issues over the next year, just to establish the administration's political credibility.

You might have noticed that in surveying U.S. trade policy for the last 20 minutes or so, I've neglected to say anything about Canada. That omission is not accidental. As far as I can make out the details of the U.S. diplomatic guide book, Canadian is one of those minor destinations that rate a single star. It's recommended if you happen to be in the neighbourhood, but not worth a special journey.

Let me say bluntly that I think there's some serious misunderstanding about this subject in Canada. I've heard it said that a new government might seek to renegotiate the U.S.-Canada Free Trade Agreement to remove some of its more objectionable provisions. That notion lies in the realm of fantasy, not political reality. Even among the strong American supporters of the free trade agreement, in whose number I include myself, there is no support to be found for renegotiation.

Whether or not Canada chooses to ratify the free trade agreement, the United States has already obtained many of the benefits it sought. Those benefits, remember, are to be found only

in small degree in the detailed provisions of the agreement. In macroeconomic terms, free trade with Canada is just not that consequential on our side of the border. From the day Peter Murphy and Simon Reisman sat down at the bargaining table, the United States was less interested in the agreement itself than in the spillover effect of a U.S.-Canada pact on other negotiations judged to have considerably greater economic significance. A trade agreement with Canada was seen as an ace on the table in the current round of GATT poker.

By and large, the Free Trade Agreement has succeeded in fulfilling that function. While its individual provisions may not work as models for GATT provisions in the way U.S. officials might have hoped, the bilateral agreement has encouraged most of America's trading partners to ante up at the GATT. Every country is now aware of the risks if the United States, the world's largest consumer of imports, turns its back on the GATT and negotiates separate agreements with favoured trading partners. Dozens of them, from Japan to Uruguay, are standing in line to negotiate their own bilateral agreements with the United States if the multilateral talks fail. Rekindling enthusiasm for the multilateral process by reminding the world of the most likely alternative is precisely what the United States wanted to achieve through its negotiations with Canada.

What will happen if the Canadian people decide the week after next that they really don't want free trade? A defeat will be regarded as a genuine disappointment in the United States, but by no means as a tragedy. Diplomatic efforts and public attention have moved on to other fronts, most notably preparing for European unification, and will not soon focus on Canada again.

But that does not mean that economic relations between the United States and Canada will return to where they were before free trade negotiations got underway. On the contrary, Canada will confront precisely the protectionist actions that Prime Minister Mulroney feared when he decided to push for free trade.

In the immediate future, President Reagan will feel less constrained from continuing countervailing duties on red cedar shakes and shingles. Within a few days of your election, he will decide whether those duties should remain in place until 1991 or end immediately. If no free trade agreement is in prospect, the odds that protection will continue are greater. You can also expect U.S. auto parts manufacturers to have more success in pressing their claim that Canada's duty remission program for auto parts is unfair. They already have a claim along those lines pending with the U.S. trade representative, who must issue a decision next week. In the present situation, it's certain that the trade representative will reject the request for retaliation. If free trade is dead, rejection of a subsequent claim is not so certain. And there are sure to be other protectionist actions as well. The preliminary finding Monday by the International Trade Commission that Canadian exports of steel rails are injuring American producers is just a taste of what is to come.

All of this, obviously, means that if the free trade agreement is not ratified in Ottawa we're likely to enter a period of increased economic tension between Canada and the United States. The consequences of that tension, obviously, would be more severe on this side of the border, where your economy is more dependent upon bilateral trade. But allow me, if you will, to be a little optimistic for just a moment. Economic tensions between our two countries would be nothing new, and I believe the basic affinity and sympathy between our two nations will overcome them.

It is clear that in Canada, as in the United States, people remain uncomfortable with the increasing integration of the global economy. Reassertion of national autonomy and national identify is an understandable response to a world in which decisions by investors and governments on other continents can raise mortgage rates, force changes in our tax structures and render our factories obsolete. We must all struggle to find our ways in this new world economy, with its uncomfortably distant forces and its unfamiliar rules. But struggle we must. Turning our backs on it is not an alternative.

U.S. TRADE POLICY AND THE URUGUAY ROUND

by Jeffrey J. Schott*

The pending ratification of the Canada-United States Free Trade Agreement (FTA) raises anew questions about the "bilateral option" for U.S. trade policy and the US commitment to multilateral negotiations under the auspices of the General Agreements on Tariffs and Trade (GATT). Will the United States continue to pursue bilateral FTAs with other countries or will it devote its efforts to multilateral negotiations in the GATT? Can--and should--it do both?

Bilateralism v. Multilateralism

Let me begin with a simple fact that is sometimes overlooked. In the postwar period, the United States has been the demandeur for all eight GATT rounds of multilateral trade negotiations, which have resulted in comprehensive tariff cuts and liberalization of many non tariff barriers to trade. The United States continues to be the leader of the GATT and the multilateral trading system, and was the country most responsible for the launching of the new Uruguay Round of GATT negotiations in September 1986.

However, support for the GATT in the United States has eroded significantly during the 1980s. The struggle to launch the new trade round left its scars and exposed serious problems with GATT that need to be remedied. Critics charge that the GATT process is too slow, that the negotiations--involving 96 countries--are too complex, and that GATT rules are inadequate or inadequately enforced. Doubts exist whether these problems can be dealt with adequately in multilateral negotiations. Such concerns are particularly strong in the Congress, where the residue of ill-will generated by the failure of the 1982 GATT Ministerial meeting still colors attitudes toward the GATT.

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Because of these concerns, the United States has adopted a bifurcated approach to trade negotiations. Parallel to the preparations for and early stages of the Uruguay Round, bilateral negotiations have been pursued with Israel and Canada to promote trade liberalization and to help build a multilateral consensus for trade reforms. The U.S. objective--true to the "bicycle theory" of trade negotiations--has been to use such talks to sustain political support for an open trade policy and the GATT negotiations. In essence, bilateralism has been used to close up the leaks in the multilateral system until more permanent fixes could be negotiated in the GATT.

Such an approach is not necessarily inconsistent with the spirit or letter of the GATT. Article XXIV of the GATT sanctions FTAs if the partner countries meet a three-part test: the agreement is notified and vetted in the GATT; it covers substantially all trade between the partner countries; and it does not raise new barriers to third country trade. The Canada-U.S. FTA meets that test better than almost all other agreements that have been notified to the GATT. It is illustrative of a bilateral agreement that also can promote the multilateral trading system.

Could the U.S.-Canada FTA be replicated with other countries? Several countries have already expressed an interest in exploring such an arrangement with the United States. Studies are underway in Japan, Korea, Taiwan and the ASEAN in response to initial US overtures for a possible FTA. Australia previously studied and rejected a bilateral FTA with the United States. In addition, Mexico has proposed a less comprehensive bilateral agreement with the United States involving liberalization in particular industrial and service sectors.

However, when one takes a close look at what would be involved in such prospective FTAs, including the U.S. barriers that might have to be removed and the implications for the world trading system, it is clear that the bilateral approach has its limits. Prospective bilaterals--particularly in the Pacific Basin--would not (with few exceptions) be complementary to GATT efforts, for several reasons:

(1) Interest in bilaterals stems partly from a disillusion in the United States with the multilateral process, and partly from a fear abroad about growing US protectionism and disenchantment with the GATT. For the most part, such agreements are seen as defensive strategies against a further weakening of the GATT system.

(2) Prospective bilaterals would promote the idea of "trading blocs"--which would threaten to become a self-fulfilling prophecy. New bilaterals would send a signal that the United States was giving up on the Uruguay Round and prompt the defensive strategies noted above. At the very least such talks would divert scare resources away from the GATT round.

(3) The United States cannot achieve the liberalization it needs from even the most extensive possible series of bilaterals. Key issues such as agriculture and subsidies require global solutions, as we learned in the negotiations with Canada. This means that, except for areas such as services and intellectual property rights, bilaterals do not hold much promise as building blocks for Uruguay Round accords.

Moreover, the much heralded advantages of bilaterals over the GATT process are illusionary. The same problems that are impeding process on the multilateral front--the unwillingness of countries to make meaningful and politically difficult concessions concerning their own trade barriers--would equally impede bilateral progress.

What does this all mean? In essence, a continuation of the two-track U.S. approach to trade negotiations--which made sense when it was unclear whether there would be a new GATT round and

when the bilateral track was limited to Canada--would be damaging to the Uruguay Round, and would not yield significant offsetting benefits on the bilateral side. Recognizing this, and with the noteworthy exception of Mexico, U.S. policy is likely to refrain from further bilaterals and focus instead on the Uruguay Round in the near-term-based on the rationale that "multilateralism is the worst of all possible systems, except for the alternatives."

Key Challenges in the Uruguay Round

That takes us to Montreal. The Uruguay Round has the daunting task of reinvigorating the GATT and restoring confidence in the multilateral trading system. The Montreal meeting need not achieve major substantive reforms to further that goal, but it does need to remove several key procedural bottlenecks that threaten to delay the start of the hard bargaining stage of the negotiations--which can only begin once the U.S. and EC negotiators who will be around at the end of the round enter the fray.

The Uruguay Round agenda is full of problems that have resisted solutions over the past seven rounds of negotiations (e.g., agricultural subsidies; voluntary export restraints and other quotas) as well as new issues (e.g. services, trade-related investment measures and intellectual property rights) where the United States and others seek to extend the scope and coverage of GATT discipline to an important share of world trade.

To date, the GATT negotiations have been workmanlike: proposals have been tabled in the 15 negotiating groups and efforts have begun to seek common ground for eventual agreements. Negotiators have made more progress than that achieved at a similar stage in the Tokyo Round, but few substantive results have yet emerged.

U.S. efforts in the Uruguay Round have centered on agriculture, services, intellectual property rights (IPRs), and institutional issues--including dispute settlement procedures--designed to strengthen the GATT framework. Not coincidentally, these are key areas where substantive results need to be attained for the Uruguay Round to be considered a success. Let me briefly describe why.

Agriculture. Questions have been raised about why the United States gives agriculture--a sector that accounts for only 13 percent of world trade--such priority in the Uruguay Round. Part of the answer lies in domestic politics. The traditional support of the farm sector for open trade has weakened because of the combined impact of the overvalued dollar of the mid-1980s and ineffective GATT discipline on subsidies. Perhaps more importantly, however, are three reasons cited by Dale Hathaway:

-- multilateral negotiations provide the most effective vehicle to stimulate needed reforms in national farm policies;

-- current agricultural trade disputes damage the credibility of the GATT and undercut efforts to strengthen GATT discipline over all trade; and

-- agricultural trade disputes threaten trade in other products since retaliation does not necessarily have to be limited to "like products".

For these reasons, substantive results in the agricultural negotiations are crucial to the overall success of the Uruguay Round. Unlike the Tokyo Round, the United States is unlikely to agree to an Uruguay Round package without a strong component of agricultural trade reforms.

Services. Nonfactor services account for about a fifth of world trade in goods and services, yet few trading rules exist to govern those transactions. The United States has worked for more than a decade to develop multilateral rules to discipline trade in services. Here again, a services agreement is crucial to maintain the domestic political coalition in support of open trade policies.

It is unlikely that the United States would accept a negotiated package that excluded new rules on services; however, U.S. negotiators recognize that--during the anticipated timeframe of the Uruguay Round--it may not be possible to develop comprehensive disciplines covering a broad range of services sectors. What the United States is likely to work for in services is a two-part approach that establishes a framework agreement or "umbrella" code of principles to guide government policies followed by sectoral annotations delimiting the coverage of the agreements.

The provisions on services in the U.S.-Canada FTA provide a model of the type of framework agreement on services that the United States advocates for the GATT as well. FTA provisions establish firm contractual obligations regarding national treatment, establishment, and licensing and certification procedures. However, the Canada-U.S. agreement does little to liberalize existing restrictions on services trade. A successful GATT negotiation will require more tangible results in the form of liberalization of specific trade barriers.

Intellectual Property Rights. The United States first raised patent, trademark, and copyright issues in the waning days of the Tokyo Round. At that time, the focus was on a new code on commercial counterfeiting. While conclusion of such a pact is still strongly advocated, U.S. policymakers have used this subject to press their agenda for high technology industries. As such, U.S. interests lie in the development of multilateral guidelines--

modeled after U.S. law, procedures, and legal precedents--regarding protection inter alia for computer software, design masks for semiconductor chips, and biotechnologies. The object is not to replace the World Intellectual Property Organization (WIPO), but rather to provide enforcement for established obligations and to develop new rules in areas where national IPR laws and regulations can have a trade-distorting impact.

Institutional Issues. It is not surprising that much of the focus of GATT talks so far in the Uruguay Round has been on issues such as surveillance of national trade policies, ministerial participation, and dispute settlement procedures. Reforms in these areas involve the form of the trade institution, not the substance of reciprocal trade negotiations, and do not directly affect domestic constituencies. Nonetheless, progress in these areas is essential if the United States and other GATT countries are to commit to meaningful trade reforms at the end of the Uruguay Round.

The United States has given high priority to these institutional issues for two key reasons. First, confidence in the GATT's dispute settlement mechanism has to be restored; countries will be loath to commit to new trade liberalization if they believe their hard-won concessions will not be adequately enforced. Second, the lack of a strong institutional foundation casts doubt on the value of negotiating new trading rules--one does not graft new limbs on a sick tree. Thus, US efforts on services and other areas are predicated on enhanced institutional arrangements in the GATT.

In particular, reform of dispute settlement procedures has been a longstanding U.S. objective. The U.S. goal is to introduce more equity and objectivity to the dispute settlement process. The United States worked hard in the Tokyo Round to elaborate new rules and procedures both in the Subsidies Code and as part of the Framework Agreement. In the Uruguay Round, it will try to build on

these achievements, along with the innovative approaches set out in the Canada-U.S. FTA, to improve the GATT dispute settlement mechanism.

Subsidies. In contrast to the Tokyo Round, U.S. efforts on subsidies have taken a much lower profile in the Uruguay Round. The United States seems to have lost faith in the Subsidies Code, and has sought to reopen the agreement to negotiate disciplines that were non-negotiable a decade earlier. This position reflects the dissatisfaction in Congress about the value of subsidy concessions gained in the Tokyo Round; many members feel they bought a "pig in a poke" in 1979 and now prefer to use the unilateral discipline of countervailing duties CVDs) rather than GATT rules to attack foreign subsidies.

In short, U.S. negotiators will be severely constrained in the subsidies area. Congress will be wary to accept any changes in U.S. subsidy/CVD practices unless significant reforms are accepted by the other major trading nations. The primary U.S. focus will be on the reduction of agricultural subsidies, both in the Code review and in the general negotiations on agriculture.

Safeguards. By contrast, the U.S. policy regarding safeguards is less constrained, but unfortunately has been no more imaginative than the approach taken in the 1970s that failed to produce agreement on a GATT Safeguards Code. Negotiators still are hung up on the "selectivity" issue, i.e. whether safeguards actions should be applied against all countries or only a select few, as well as the related problem of Code coverage of "gray area measures" such as voluntary export restraints (VERs). These issues are related because most safeguard actions now take the form of VERs. While such measures appear to be selective, in fact VERs usually have to be extended to almost all suppliers to prevent leakage through uncovered countries. As such, VERs have become a vehicle to

globalize trade restraints in textiles and apparel, steel, and perhaps soon in autos (in Europe). Resolution of both problems is needed to induce countries to impose trade restrictions pursuant to GATT Article XIX instead of outside the GATT system.

Investment. U.S. negotiators will continue to push for new rules to cover trade-related investment measures (TRIMS). To date, the talks have focused on investment incentives and performance requirements--measures that can have significant trade effects. The issue of establishment rights has provoked more controversy. Overall, however, the TRIMS negotiations have not generated extensive interest among GATT delegations; indeed, even the US approach has been muted.

After the mid-term review, the United States is likely to place more emphasis on the TRIMS negotiations, building on the precedents set out in the Canada-US FTA. FTA obligations on performance requirements--which go beyond existing GATT practice as elaborated in the 1983 panel report on the Canadian Foreign Investment Review Agency--and FTA coverage of practices by states and provinces could provide useful precedents for a GATT accord.

Conclusion

The United States was the driving force behind the creation of the GATT, and it remains today the leading proponent of a strengthened GATT trading system. The United States has been the demandeur of all eight rounds of GATT negotiations. No other country has made as great a commitment nor taken as much responsibility for the pursuit of multilateral trade liberalization in the postwar era. These facts should be kept well in mind. Despite a pronounced drift toward protectionism and bilateralism,

U.S. trade policy is still based on GATT rights and obligations. U.S. negotiators will continue to work hard in the Uruguay Round to achieve a result that strengthens the GATT and the world trading system.